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Financial policy proposed in -- Council Resolution.

The resolution is obviously intended to be a declaration of financial policy in the triennium and I take it that the broad features of such policy are the following:

(1) A condition of annual deficits in the triennium commencing with the current year is assumed to be an inevitable necessity. It is held to be impossible to maintain the standard of expenditure at its present level and it is therefore proposed to allow it to grow to the extent of at least 4 lakhs in the first year, 7½ lakhs in the second year and 11 lakhs in the third year, increasing the deficit in 1922-23 to about --- 34 lakhs.

(2) Such annual deficits are proposed to be continued until the full return from the large investments made on productive works is realised and applied for reducing and removing them.

Importance of the policy.

2. The adoption of this policy is, I think, fraught with serious consequences and the deepest consideration is necessary before it is acted upon. It is impossible to overestimate the importance or the gravity of the step proposed to be taken and I consider it therefore my duty to explain, as plainly as I can, the financial situation now and in the near future so that the position may be properly appreciated before final orders are passed.

Deficit began in 1918-19

3. The deficit condition of our finances really began in 1918-19 and it was due to the sanctioning of expenditure irrespective of revenues and to the wrong application of the system of departmental settlement, which was brought into force from the previous year. The essential features of the System are two:

(1)

(1) limiting of expenditure to available revenues by means of a well thought out programme of distribution of funds among the Spending Departments, and (2) allowing freedom to such departments in utilising the funds allotted to them, without the limitation imposed by the previously existing rule of lapses. Both these features will make for financial orderliness and administrative effeciency if the System is properly worked, but the merit of the system was converted into a defect by the wrong use made of it. The annual recurring expenditure of no department can, according to the System, exceed its share of the annual revenues including the growth of revenue, if any, allotted to it; but this limit has been permitted to be exceeded ~~in most cases~~ on the strength of unspent allotments of a previous year held at the disposal of Departments or even without any balance. In my General Review on Budget Estimates written as Comptroller, I repeatedly pointed out (vide my notes dated 26th March 1918 and 5th March 1919) the risk of ~~xxxx~~ allowing such limit to be exceeded, but my representations did not receive any attention. The excesses, which it was the object of the System to effectively prevent, were permitted and the following figures will show what I mean:

(In thousands of rupees)

Year	Share of revenue.	Expre.	Saved	Overspent
Direct Demands on Revenue	1917-18	39,81	36,42	3,39	..
	1918-19	35,68	39,44	..	3,76
	1919-20	39,48	46,46	..	6,98
	1920-21	39,21	50,45	..	11,24
Staff & Household of H.H.	1917-18	4,32	3,98	34	..
	1918-19	3,52	6,05	..	2,53
	1919-20	3,50	6,59	..	3,09
	1920-21	3,63	9,38	..	5,75
Civil Administration	1917-18	29,67	28,57	1,10	..
	1918-19	29,04	30,22	..	1,18
	1919-20	29,05	35,66	..	6,61
	1920-21	28,96	40,15	..	11,19
Protection & Army	1917-18	45,34	41,93	3,41	..
	1918-19	42,65	50,83	..	8,18
	1919-20	43,01	60,91	..	17,90
	1920-21	43,38	64,47	..	21,09

Contd.

Contd.

	Year	Share of revenue.	Expre.	Saved.	Overspent.
Public Works	1917-18.	31,48	28,26	3,22	..
	1918-19	29,68	35,33	..	5,65
	1919-20	29,06	33,91	..	4,85
	1920-21	29,24	32,68	..	3,44
Moral & Material Development	1917-18	52,64	39,24	13,40	..
	1918-19	45,02	51,86	..	6,84
	1919-20	46,29	52,58	..	6,29
	1920-21	45,53	64,50	..	18,97
Local Self-Government	1917-18	10,25	8,74	1,51	..
	1918-19	10,25	6,27	3,98	..
	1919-20	10,25	6,50	3,75	..
	1920-21	..	7,87	..	7,87

The recurring expenditure (col.4) should not exceed the allotted share of revenue (col.3) and after the annnual standard of recurring expenditure reaches the level of annual resources assigned to a group of Departments, its past savings, x if any, can ~~only~~ be used only for non-recurring charges. It will be seen from the abo statement that this fundamental rule has been infringed and the departments have been permitted to increase thei standard of annual expenditure beyond their share of annual revenues.

Financial position in five years from 1916-17.

4. The following statement shows the financial position on the whole, in the five years from 1916-17:

(In thousands of rupees).

	1916-17.	1917-18.	1918-19.	1919-20.	1920-21.
Total Revenues ..	299,06	315,25	294,24	313,12	315,25
Actual Expenditure..	244,36	256,54	289,29	315,37	344,26 *
Contribution to Reserves--					
Mining Rev.Cap.Fund	9,27	8,72	7,11	6,03	4,83
Sinking Fund ..	3,33	3,33	3,33	3,33	3,33
Famine ..	5,00	5,00	5,00	5,00	5,00
Total Contribution	17,60	17,05	15,44	14,36	13,16
Total Expenditure including Reserves	261,96	273,59	304,73	329,73	357,42
Surplus ..	37,10	41,66	..	..	..
Deficit ..	..	..	10,49	16,61	42,17

* As per Budget 1920-21 353,66

. High prices allowance in excess of budget provision 5,00

Potai De since sanctioned due .. 60

1,00

Continuous deficits from 1918-19.

5. I have included under Expenditure only three Reserves, viz., Famine Insurance, Mining Revenue --- Capitalisation and Sinking Fund. All these must form the first charge upon the annual revenues, the first fo for saving the lives of the people, should unfortunatel y a famine occur, the second for ensuring stability of administration, as the Gold Mines will cease to pay sooner or later, and the third for guaranteeing the dis charge of loans borrowed. It will be seen from the abo above statement that taking the actual expenditure and only the contributions to these absolutely essential reserves and excluding all other reserves contemplated in the Financial Settlement Scheme, the position is one of a deficit in every year from 1918-19.

Course of Revenue and Expenditure in five years.

6. The figures given in the above statement also show the course of revenue and of expenditure and the striking features are the practically stationary state of total revenue and the rapidly increasing character of the standard of expenditure. In the period of five years for which the above figures are given, it will be seen that while revenue ranged from Rs.299 lakhs to Rs.315 lakhs, the actual expenditure excluding reserves expanded from Rs.244 lakhs to 344 lakhs.

Large deficit in Budget for 1919-20 not shown as such.

7. Even after making allowance for amounts available to the credit of departments and reserves out of past savings the position in 1919-20 was one of a deficit of over 15 lakhs when the Budget for that year was framed. But the real deficit was concealed as expenditure on the grant of high prices allowance, etc. estimated at about 14½ lakhs which was properly chargeable to the revenues of the year, was proposed to be met fro the Famine Insurance Fund. This Fund is intended for saving the lives of the people in the event of a Famine and it cannot be permitted to be diverted for meeting

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an item of expenditure on ordinary administration and frittered away in two or three years. This was pointed out in dealing with the Budget for the current year an d the charges will, according to the orders passed, be take n against the revenues of the year.

Reports regarding deficits.

8. That deficits would result by permitting department to spend more than there are revenues to allot to them, I have been pointing out from as far back as March 1918. An elaborate Financial Review and Forecast was published in September 1919 and it showed that the position was one of an annual deficit of about 16 lakhs. This position became worse when the Exchange rate rose above 1s.10d. on which the calculations in the Review were based. The effect of the higher rate of exchange was brought to --- notice in my note dated 15th August 1919. Again in my proposals dated 16th February 1920 about the revision of the terms of the Financial Settlement, I drew pointed attention to the state of deficit caused by the reduction in revenue and increased expenditure due to the grant of high prices allowance. It will be seen from these facts that a condition of deficits is no surprise now sprung on us but it has been there since 1918-19.

Total deficits in five years.

9. The financial position has been continuously --- unsound from 1918-19 and in the three years ending with the current year, the total deficit calculated with reference to the annual revenues and the annual expenditure amounts to 69.27 lakhs, or to 73.27 lakhs if another 4 lakhs of additional expenditure should be permitted accord ing to the Council resolution. The Council Resolutions proposes to permit increased deficits during the next two years as well, amounting to Rs.76.98 lakhs, after taking into account the anticipated growth of about 20 lakhs in the two years.

Unavoidable additional expenditure not provided for in the -- Forecast.

10. All the items of growth of revenue on which we can count have been included in the above calculations. The Expenditure forecast however, does not take into account many items which are likley to become irresistible. There are some demands of an insistent character which will have to be met sooner or later. There is a very active agitation in British India on the part of retired officers for enhancement of their pensions to compensate them for dearness of living and the Governme of India appear to have sanctioned some relief to them. If pensioners in British India are shown such considerati on it will be impossible to resist a similar demand by the Mysore service pensioners. There is a proposal to compensate the sowars for dearness of grass and to abolish the silledari system altogether. The Medical Department is finding it very difficult to get Sub Assistant Surgeons and there is a strong demand for increasing their rates of pay. As the scales of pay of the superior services have been improved in British India, the correspond ing services here are also clamouring for some reasonable addition to their emoluments. One instalment of liberalisation of leave rules has already been sanctioned and another will have to be considered soon. The Acting and Travelling Allowance rules and the pension rules have either been altered or will soon be altered by the Govern ment of India. Our rules are based on theirs and sooner or later we have to follow them. All these changes will entail additional cost which it is not possible to avoid. Besides these demands some increases are incidental to administration in most departments and there must be some margin for meeting them. The expectation of the Council Resolution that the deficit in 1922-23 can be limited to 34 lakhs cannot thus be realised. As a matter of fact, new expenditure of 1½ lakhs per annum has since been --- sanctioned in addition on account of potgi and high pri-

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prices allowances. Apart from new items of expenditure which may become inevitable, the present level of expenditure on existing services and activities is bound to increase even simply as the result of the largely increased and still increasing level of wages and prices.

Any addition on account of the various demands mentioned above, will of course increase the total deficit in 1922-23 . A condition of increasing deficits continuously during a period of five years which aggregate 150.25 lakhs in that period and an annual maximum deficit of 36.76 lakhs in the last year of the quinquennium even after all growth of revenue has been taken into account, with no prospect of any assured means of its being wiped out or substantially reduced from the sixth year cannot but cause the gravest anxiety.

Inelastic nature of revenues.

11. There is one feature of our finances which should never be overlooked. We have no elastic sources of revenue and the adjustment of income to the level of expenditure required in any year is not a resource which is open to us. We have no taxes like Customs, the rates of which can be raised or lowered according to the varying demands of the administration. The solitary item of such revenue we have, is the income-tax, which was only very recently imposed and it is not advisable to raise the rates of its levy in the near future and even if the rates are increased the additional yield is likely to be very poor as the taxable income of the people is, after all, small and the rate of its annual growth is not also large. In view of the inelastic character of our revenues and of the growing tendency of public expenditure , we should always have some margin of revenue for meeting new and necessary charges and never allow expenditure to grow faster than revenue.

'ustification urged for proposed policy considered.

12. I shall now consider the justification urged for the policy proposed in the Council Resolution. It is assumed that a condition of deficit in the triennium is an inevitable necessity and that it is also necessary to permit the deficit to grow. The implication of the assumption would be that the existing situation does not call for any remedy, whatever, whether by way of improvement of revenues or of reduction of expenditure, or by the adoption of both these measures. How a condition of chronic deficits of the magnitude mentioned above, is considered as calling for no immediate action for mending it, it is very difficult to understand. Deficits can never be matter for no anxiety, but when they have attained the proportions pointed out above, and when they are also continuous and increasing with no certain means of wiping them out, the position is grave enough for immediate action. If a condition of deficit is taken to be a necessity and the deficit itself is permitted to grow, the inevitable inference is that the existing standard of expenditure does not admit of reduction and that there is no possibility of improving the sources of revenue. If this is really the position, the question naturally arises where is the justification for continuing the present --- level of expenditure or for increasing it. The reason -- urged for the proposed policy is that a contraction of expenditure will result in a set back to administration. But it is a fundamental principle of public finance that the cost of administration can never exceed the revenue which can be raised for meeting it, or, in other words, there can only be as much administration as there is money to finance it. If expansion of public expenditure is a sign of healthy administration, a corresponding increase of public revenue is an imperative condition precedent to make such healthy administration possible. Administration comprehends both raising of revenues and expending them

and it is unsound not only financially but also otherwise to measure its progressive character only by the expansion of expenditure.

Policy of Budget deficits and of meeting them from loans considered.

13. The following extract reproduces the unanimous recommendation of the Committee of Financial Experts which recently met at Brussels under the auspices of the League of Nations:

(From the Bankers' Magazine, November 1920, Pages 576 and 577)

"IMPERATIVE REQUIREMENTS.

The country which accepts the policy of Budget deficits is treading the slippery path which leads to general ruin; to escape from that path no sacrifice is too great. It is therefore imperative that every Government should, as the first social and financial reform on which others depend:

(a) Restrict its ordinary expenditure, including the service of the debt to such an amount as can be covered by its ordinary revenue,

** ** **

(e) Abandon all unproductive extraordinary expenditure,

(d) Restrict even productive extraordinary expenditure to the lowest possible amount."

"TAXATION TO MEET DEFICITS.

In so far as after every effort has been made it is impossible to cut down expenditure within the limits of existing revenue, fresh taxation must be imposed to meet the deficit and this process must be ruthlessly continued until the revenue is at least sufficient to meet the full amount of the recurrent ordinary expenditure.

"If the above principles are accepted and applied, loans will not be required for recurrent ordinary expenditure; borrowing for that purpose must cease."

When Governments whose finances have been so badly disorganized by War expenditure are advised to immediately balance their budgets and not allow loan funds to be

employed for meeting the cost of current requirements, there is absolutely no justification for permitting deficits for purposes of ordinary administration.

Resort to borrowing for purposes f of ordinary administration is permissible only in the case of an unforeseen shortage in estimated revenue or of an unforeseen item of expenditure which will not admit of delay. The deficit which confronts us is not of the description due to either of these causes. The reduction of revenue that has occurred is not a temporary shortage due to an unforeseen factor which has delayed the realisation of estimated revenue but a permanent decline in the ~~xxx~~ level of resources. The growth of expenditure again, is not due to the need for meeting any items of temporary outlay special to a particular year not foreseen when the budget of the year is framed and also not brooking delay. The increase in the level of expenditure is permanent and additional recurring expenditure cannot be met from temporary borrowings permissible in the case of casual deficits due to deferred revenue or to an urgent item of expenditure, the finance for which cannot immediately be provided from revenue, but which can be provided from realizable revenue shortly after payment.

Bastable Page 670.

As regards the policy of resorting to borrowing for meeting the cost of ordinary administration this is what a very high authority on Public Finance states:

> "Non-economic expenditure is primarily to be met out of income and unless it can be so dealt with, ought not be incurred. National culture, education and the promotion of social progress are all most desirable but their promotion is not so urgently required as to need the use of borrowing by public powers."

Assumptions that revenue cannot be improved and that expre.cannot be reduced implied by proposed policy considered.

14. I do not think it can be assumed that there are no items of revenue capable of improvement or that there are no items of expenditure admitting of reduction. There must be many items of expenditure of a more or less optional or avoidable or deferrable character and they must wait until funds

funds can be found for them. As for revenues some of t certainly admit of considerable enhancement; for instan I understand that the resettlement of as many as 30 tal i.e., about half the State, is in arrears and that some of them have been in that condition for 10 years and mo The price of agricultural produce has gone very high an the delay in ~~the~~ resettlment is depriving the Public Tr sury of revenue which it so badly wants and which the a culturists can so easily pay.

Effects of successive deficits on borrowing.

15. The effect upon our financial credit which will l produced by continued deficits when our capital commitments make it obligatory to resort to public borrowing i a relevant point to be considered in this connection. Wi recurring deficits how shall we meet the interest charge and sinking fund charges of the loan to be raised by us Would not the investing public desire to be assured of t financial capacity of the State to meet its obligations in respect of such charges? The Government of India hav already raised this objection in regard to the loan rais by us this year but it is not possible to give a satisfactory answer to it with deficit budgets. With recurring and increasing deficits , our position in respect to borrowing will become more and more indefensible and th public and the Government of India will have just cause t complain that a policy of public borrowing cannot be pur sued by a State which cannot provide for the service of loans from its annual revenues.

How the deficits have been viewed by the Legislative Council and Representative Assembly.

16. The deficits in the last and current years have already evoked much adverse public criticism. Both the Legislative Council and the Representative Assembly have viewed them with great concern and requested Government to take measures for restoring equilibrium. The proposed policy of permitting the existing deficits to continue and also of increasing them is bound to call forth very

hostile

hostile criticism and it will be extremely difficult to defend such policy.

Summary of consequences of proposed policy.

17. I shall now summarise the effects of the policy proposed to be adopted. A policy of deficit financiering would lead to borrowing for meeting the cost of ordinary administration. The payment of interest upon the loans raised will have to be made from borrowed funds. There would be no means for ensuring the repayment of loans contracted as no sinking fund can be formed when there is no surplus to be devoted to it. We cannot raise a loan for paying the annual contributions to the Sinking fund as it is futile to borrow with one hand and pay back with the other. With recurring and increasing deficits the sinking fund contributions must be suspended and such suspension is bound to be criticised by the public and it will also adversely affect our further --- borrowing. We raised a loan of 140 lakhs this year and the policy proposed will leave no means for forming a Sinking Fund even for this loan. The loan is redeemable on a particular date and its discharge should be guaranteed by Sinking Fund contributions from annual revenues made with religious regularity. It is impossible to --- defend abandon the policy of abandoning the Sinking Fund as no expenditure on any service however useful can claim to have precedence over the service of debt. We have been following a policy of setting ~~xxxx~~ aside annually a sum of Rs.5 lakhs as a Famine Insurance Fund with a view to be ever prepared with liquid resources of sufficient magnitude for saving the lives of the people in the event of there being a famine. This policy has been adopted by the Government of India also and it has been reaffirmed in the financial arrangements made according to the Refer Scheme

Scheme which requires every provincial Government to compulsorily effect an annual saving equivalent to the contribution to be made to the Insurance Fund to be built up by it. If we permit annual deficits, it is impossible to make any more contribution to the Famine Insurance Fund. The suspension of such contribution will certainly not be received well by the public nor is it right to cease to add to the Fund. It has been decided after prolonged discussion that it is necessary to save 60% of the revenue from Gold Royalty with a view to build up another revenue-producing asset to take the place of the Mines when they cease to pay. If annual deficits are allowed, the contribution to the Mining Revenue Capitalization Fund must also go and it is highly inadvisable to abandon a measure introduced after great deliberation and intended for financial stability. A fund called the Industrial Development Fund has been ordered to be formed from annual contributions of a lakh and a half for the purpose of undertaking experiments in the interests of industrial development. If an annual surplus to the extent of a lakh and a half is not available, how is this fund to be fed? or, if the fund is to be given up, are all experimental measures to be abandoned ? It has been arranged according to the financial settlement to save a sum of Rs.3½ lakhs annually for meeting irregularly occurring extraordinary expenditure like that on the Viceroy's and Royal visits. With a deficit this special reserve will have to go and there would be no means of meeting such expenditure.

Contribution to financial reserves cannot be met from past surpluses.

18. It is true that past surpluses have enabled us to build up net assets of about six crores of rupees and it may perhaps be argued that the demands on account of the various reserves may be met from such surpluses. This view cannot be maintained as the objects of the different reserves will be completely frustrated if the method of paper adjustment is adopted for building up the funds.

For instance, the Mining Revenue Capitalization Fund is intended to form a new asset for earning additional revenue. The substitution of an old asset, the revenue from which is already being spent will not answer the purpose. The Famine Insurance Fund should be in cash or in a form convertible into cash at a moment's notice, for providing for the many demands to be met on the occasion of a Famine and the assets built out of past surpluses which are mostly in the form of productive works like railways and the Cauvery Power Scheme can neither be sold nor pledged for obtaining the cash reqd. The Industrial Development Fund and the Special Reserve are inteded for meeting cash outlay and their requirements cannot be met from assets in the form of machinery, rails and rolling stock or brick and mortar into which the past surpluses have been mostly converted.

Financial position in last year of period of surpluses compared with that in last year, for which policy is now proposed.

19. For a long number of years upto 1917-18, our position was one of large annual surpluses and there was accordingly ample margin for growth of expenditure. It is necessary to realise how radically the situation has since altered for the worse and to bring out the deterioration in the position I append a statement in which I compare the actuals for 1917-18, the last year of the period of surpluses, with those for the year 1922-23, the last year of the triennium under consideration. I request particular attention to this statement as it shows very clearly the past and the proposed condition of finances. In the period of 5 years, the growth of departmental expenditure will be 108 lakhs against a growth of revenue of 33 lakhs. How rapidly the standard of expenditure is being increased quite irrespective of the growth of revenue, which alone can warrant addition to expenditure is, I think evident from these figures which represent hard fact. The increase of about 108 lakhs is the result of the utilization of the surplus of 26 lakhs, of the complete ---- abandonment of all the financial reserves amounting to about 32

Contributions by the different heads is indicated in the Statement. I think this Comparative Statement will convince anyone, however sceptical, how seriously unsafe the position has become.

Rs.32 lakhs, of the absorption of the whole growth of revenue of 33 lakhs and also of the creation of a deficit of 17 lakhs. The surrender of all reserves including such obligatory provisions like the Famine Insurance and Loan Sinking Fund and the creation of a large annual deficit to be covered by borrowing are the most serious consequences of the --- proposed policy.

Expectation of future additional revenue from productive works considered.

20. I shall now consider if there is any foundation for the expectation of the proposed policy that the deficit permitted by it will be made good from the future revenue of productive works. I understand that taking the Iron works and the connected tramways, the capital cost will stand is estimated at about Rs.150 lakhs during the next 4 or 5 years and that in the same period the total investment is expected to pay about 6 per cent., i.e., about 8 lakhs per annum. Of this, 3 lakhs have already been included in the growth of revenue taken in the Forecast and the balance that may be expected will be about 5 lakhs. The other large investment is on the Krishnarajasagara Works, the irrigational side of which --- practically remains undeveloped. This project has already cost us Rs.170 lakhs and the annual return from it is about 3 lakhs, i.e., less than 2 per cent. Whatever additional -- revenue from the Sixth Installation may be attributed to the Reservoir has been already included in the forecast as the full income from this Installation has been taken into account under the Electrical Department. I understand that it takes a very long number of years for big irrigational works to pay and there is accordingly no near prospect of the Reservoir yielding any large amount to ease the financial situation. An annual growth Re.1 lakh from Land Revenue has been taken in the Forecast and in this growth is included income expected from the irrigational use made of water in the Reservoir. Our railways worked by the Company and the lines recently restored by them to us are paying as much as they can be --- expected to pay and it is not safe to expect any large addi-